Opportunity Zone - Trailer Bill Language
FACT SHEET
August 22, 2019

Proposal Summary:

Provide tax breaks that conform to the federal tax breaks for investments in qualified California Opportunity Zone projects.

Background:

The Tax Cut and Jobs Act created Opportunity Zones (OZs). All states were allowed to designate qualifying census tracts as OZs in certain low income areas. California participated in that process and last spring designated 879 OZs throughout California, with at least 1 per county where possible. Investment in OZs is encouraged by a temporary deferral of any capital gains if the taxpayer re-invests those gains in a qualified OZ Fund within 180 days of realizing the gain. If those gains are held in the fund for 5 years, that taxpayer receives a 10 percent exemption when the gain is realized. If the gains are held for 7 years, the taxpayer receives a 15 percent exemption when the gain is realized. All of the deferred gains must be realized, along with any exemption, by the end of 2026. In addition, any gains achieved within an OZ fund are tax free if held for 10 years or more. Note that only investments using reinvested capital gains qualify for the tax free treatment after 10 years.

Proposal:

We are proposing to conform to these tax incentives for investments in an OZ Fund that are directed to projects that are both within a California OZ and are either affordable housing or green tech. Because of the generous federal tax breaks, it seems very likely that investment dollars will be flowing into OZs across the United States. The purpose for our proposed conformity is to provide an incentive for investors to invest those dollars into California OZs and provide economic development benefits to Californians. And we want to do it in a way that encourages the right type of investment that actually does benefit California and Californians who live and work in economically disadvantaged areas by having local and state involvement and monitoring.

Low income housing would be defined using the same parameters as qualification for the existing low-income housing tax credit or the State Density Bonus Program. The project must meet any of the following 3 criteria

1. Provide at least 20% of its units to households with less than 50% of area median income (AMI), and enter into a long-term agreement with the California Tax Credit Allocation Committee (CTCAC) for oversight, or
2. Provides at least 40% of its units to households with less than 60% of AMI, with an agreement with CTCAC for oversight, or
3. Qualify for the State Density Housing Bonus and restrict at least 15% of its units to households with less than 50% of AMI, or 30% of units to 60% of AMI, with information sharing between locals and FTB for oversight.

This approach will provide encouragement for both low and mixed income housing. The low-income-housing tax credit by itself incentivizes projects that are focused wholly on low-income housing; since the actual credit is based on the total share of housing that is deemed to be low-income housing. But the OZ tax benefits would be unaffected by projects whose share of low-income housing exceeds the minimum 20%/50% or 40%/60% thresholds. As such the OZ tax breaks will create a new incentive for projects that meet the minimum thresholds for low-income housing but also focus on moderate-income housing.

For green tech, the project must fall into one of the existing programs the state runs to reduce emissions, with FTB given broad authority to update the list to ensure the programs to certify projects reduce emissions and allow oversight by the state over time. This list may include but is not limited to the following:

1. It is primarily engaged in those lines of business described in Codes 22111 to 22118, inclusive, or 21222, of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012, only if engaged in making, producing, creating, or converting electric power from sources other than a conventional power source, as defined in Section 2805 of the Public Utilities Code.
2. It is a photovoltaic system that meets the prescriptive or performance standards set forth in the 2019 Title 24, Part 6 Building Energy Efficiency Standards Rulemaking, Sections 150.1(b) and 150.1(c) by the California Energy Commission
3. It is a "distributed energy storage system" or an "energy storage management system" as defined in California Public Utilities Code Section 2838.2 and approved as such by the California Public Utilities Commission
4. It is a distributed energy resource technology as defined in California Public Utilities Code, Section 8370 (b) and determined to meet this definition by the California Public Utilities Commission and the California Air Resources Board.
5. It is a load modifying demand response resource as established by the California Public Utilities Commission in implementing California Public Utilities Code Section 380 (j)
6. It achieves energy efficiency savings as determined by the California Public Utilities Commission in accordance with California Public Resource Code Section 25310 (c) and (d)
7. It is an "Electric Vehicle charging station" as defined by Section 65850.7 of the California Government Code and certified by a city or county government in California.

Safeguards

A California qualified OZ fund would invest in an OZ business. To be a qualified fund, it would need to hold at least 90 percent of its total assets in qualified property and hold any remaining assets in cash, other liquid assets, or tangible property located in California. Transfers of intangibles would be prohibited.

The FTB would allocate qualified capital gain deferrals on a first-come first served basis to OZ funds, as long as the fund is requesting an allocation of less than $100 million. The total amount of qualified deferrals that may be allocated is limited to $5 billion. Although the eventual revenue loss is difficult to estimate, it will be limited due to the cap on investment.

FTB will check on the OZ fund one year after the allocation is granted. Any amounts that have not been raised by that time will be subtracted from the total allocation and that amount shall be added to the available balance to be allocated. The funds also need to maintain their federal certification. Qualified funds shall report to FTB every 6 months on (1) the total amount of capital raised, (2) the total amount of capital invested in qualified property, and (3) the date investments were made. Qualified funds shall report to FTB annually. The items reported may include but are not limited to (1) number of low-income housing units created, (2) the number of jobs created along with average wage, and (3) the alternative electricity production capacity created.

The FTB shall report to the Legislature at least annually the information provided by the qualified funds. A taxpayer investing in a qualified fund must report the deferred gain with zero basis adjustment in the current year that the qualified fund either has not properly invested in qualified property, or the qualified fund has not reported to FTB as required. Such a taxpayer also loses any basis adjustment for gains within the qualified fund. The TBL also includes Section 6 penalties for qualified funds that do not report to FTB as required.